MORTGAGE BULLETIN

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

ROY WENZLICK & CO.

Real Estate Economists, Appraisers and Counselors

SEPTEMBER 17
1948

Volume XVII

Number 42

THE NEW HOUSING ACT AND INFLATION

NO one with his head on straight can accept current trends with any degree of complacency. Last spring, after the sharp drop in the commodity index, it appeared that the forces of inflation and deflation were balanced against themselves and many hoped --- and some feared --- that the inflationary spiral might be slowing down. However, the hoped-for reversal in rising prices, followed by reduction of pressure on the critical wage fronts, failed to stick and this summer witnessed the manifestations of inflationary pressures which forced wholesale prices to an all-time peak. The balance now seems on the inflationary side and the one certainty about the price spiral is that it is still grinding onward and upward. The danger is not so much in the immediate result, although that is important, as in the cumulative effects.

Long-term prospects are not improving but the trend of business continues upward on a wide front. The building industry is in the van of activity with residential construction booming along at an astonishingly fast pace. During the first seven months of this year 556,300 housing units were started, which is 119,900, or 27.5 per cent, more than were started in the same period of 1947. As it did in 1947, Los Angeles leads in housing permits issued, with New York City second. It looks now as though the total starts for the year would be in a bracket well over 900,000 units, and the Department of Commerce estimates that the dollar volume will be $7.1 billion. This deluge of new construction confirms, at least for 1948, the opinion of those builders and lenders who have maintained that rising costs would not slow down home building.

Despite the record-breaking output of homes there is a constant complaint over the housing situation and a clamorous insistence for further government subsidies, guarantees and other assistance planned to increase residential construction. The response to this urgent demand for more easy housing credit is the "modified" housing measure adopted at the special session of Congress, signed by the President, and cited as the "Housing Act of 1948." At this writing, August 23, the interpretations of several sections of the Act have not been completed and offices of the Federal Housing Administration are not as yet accepting any applications for mortgage insurance except on Title I and Section 608 of Title VI. However, it may be of interest to review briefly some of the features of the new Housing Act.

First of all, it is obvious that some of the changes approved in the new regulations, by a session of Congress called primarily to take action on anti-inflationary proposals, are definitely inflationary. One of the features decidedly on the inflationary side is the provision for Fanny May (Federal National Mortgage Association) to purchase from any lending agency up to fifty per cent, instead of twenty-five per

cent, of the FHA and GI mortgages in its portfolio insured after April 30, 1948. Through this secondary market a large amount of money will be released for reinvestment in home mortgages at a time when the Federal Reserve Board, and Secretary Snyder of the Treasury, are warning of the danger inherent in the further expansion of mortgage debt. Permitting the VA administrator to increase the interest rate to 4-1/2 per cent on GI home mortgages, with approval by Secretary of the Treasury, should boost the market for small homes. Of course, this increase in interest is but bait for institutional lenders who have lost their enthusiasm for taking these 4 per cent loans. The loan limitation for Title I has been raised from $3,000 to $4,500 and the mortgage may run for twenty years at 4-1/2 per cent interest. To accelerate the construction of large-scale rental housing an additional $800 million of mortgage insurance is provided for Section 608, Title VI, with a loan limit of $8,100 for each family unit instead of the old limit of $1,800 a room. This extension and liberalization of Section 608 is a flagrant concession to inflated construction costs but should provide around 90,000 to 100,000 apartments in projects which have been lying on the drawing-boards awaiting the authorization of more mortgage insurance. Now, under the new Section 611 of Title VI, on-site builders of twenty-five or more single-family houses, selling for not more than $7,500, can secure construction loans up to 80 per cent of valuation, or $6,000, whichever is less, at 4-1/2 per cent interest. Title II has been liberalized to include thirty-year mortgages at 95 per cent of valuation of the home with a limit of $6,000, and at an interest rate of not over 5 per cent. Or the home buyer can obtain a 4-1/2 per cent, twenty-five year 90 per cent loan, if the mortgage does not exceed $6,300. On houses costing above $7,000 the percentage of the loan is reduced until it is 80 per cent at $11,000. There is also assistance for manufacturers and builders of prefabricated houses, and provisions for the so-called yield-insurance section guaranteeing a return of 2-3/4 per cent on low-rent apartment projects.

In our opinion the "Housing Act of 1948" should not have been passed. Expanding home mortgage credit on such slender terms that in some cases scarcely any owner-equity is needed is unsound and imprudent financing, and indubitably inflationary. As The National City Bank of New York noted in its July letter, "The residential building situation already affords what might well become a textbook example of inflation at work. An immense potential demand has been turned into an effective demand, in excess of supply, by an immense expansion of credit on easy terms." This interesting comment comes from the vice-president of a large New York City savings bank: "To answer your question as briefly as your question is, I would say that the Housing Act of 1948 is one of the most inflationary moves that has taken place in the year 1948."

The new "Housing Act" will undoubtedly give a fillip to mortgage financing, to the operations of real estate men and to the business of mortgage brokers, who need it badly. It will likely result in only a slight increase in construction as houses are now being built about as fast as the supply of materials will permit. But the excessive housing demand, fed by more easy credit, will bring an appreciable rise in already astronomical building costs. The new Act will be more effective in large city areas where the greatest volume of FHA financing has been done.

A legion of real estate brokers, and some builders and mortgage brokers, have been bandying talk, since last winter, that mortgage money is "too tight." However,

an examination of the record shows that the 532 mutual savings banks increased mortgage loans $278 million during the first six months of this year and member associations of the United States Savings and Loan League financed home loans to the tune of $1,156,000,000 up to June first, and increased new home financing 34.8 per cent over the same period a year ago. Add to this financing the large amounts invested in mortgages by life insurance companies, commercial banks and others, and the complaint of tight mortgage money hardly holds water. The record volume of housing construction could not have happened without the full cooperation of the lending agencies. And now that the spigot has been turned on in the generously replenished reservoir of Federal mortgage insurance there should be more financing funds available than there will be properties to finance.

The primary aim of institutions making loans on real estate now is to increase their portfolios. While there are many institutions which show a strong penchant for mortgages protected by FHA insurance, there are far more who prefer to finance loans on a conventional basis. Under the existing inflationary conditions the conventional lender must contend with greatly exaggerated risks. The loans now most available are on new homes. But making commitments on newly constructed houses, built at fantastic costs and selling at top-drawer prices, calls for the most careful screening of applications. It also requires a broad familiarity with residential construction costs and a keen realization that the risk of a future drop in present loan value is a concomitant hazard of the current market. And finally, it demands the fortitude to turn a stone deaf ear to builders and real estate brokers who confidently insist high building costs and the excessive demand for housing will continue for a long time.

From our discussion with lenders on the present situation regarding conventional loans we believe that what happens to construction costs will hold the key to future mortgage financing policies of many institutions, and mortgage executives are watching carefully for any indications of a reversal in the upward march of prices.

After what we have heard and seen we have come to the conclusion that the attitude with respect to the present mortgage situation is one of growing uneasiness and some confusion. There are many reports of stiffening interest rates and tightening commitments but with conflicting announcements from other lenders intimating that ample funds are at hand on a conventional basis for any number of loans. Recently we have talked with several bankers whose institutions finance mortgage loans in metropolitan areas and who hold that the tide of inflated prices for real estate is slowly turning. These men point out that newly constructed houses are not selling as fast as they did a few months ago and, in some instances, only at a concession from the original price. Other lenders have noted a steady but not as yet alarming increase in delinquencies and here and there a request for a second mortgage against an equity already acquired. The report we hear most frequently is that the high prices of homes are forcing buyers out of the market. More and more applications are being turned down because the applicants haven't either sufficient funds for a satisfactory down payment or enough income to carry the loan under the stress and strain of rising living costs. An interesting and significant study for lending institutions is the "1948 Survey of Consumer Finances" issued by the Board of Governors of the Federal Reserve System.

Elliott Bell, Bank Commissioner of New York, once said: "There has never

been a boom in real estate except where the lenders made it possible." And Mr. Bell is right. As a corollary to the present real estate boom institutional lenders have made every effort to increase their portfolios. During the past three years mortgage money has been available in larger amounts, at higher loan-to-value ratios, at lower interest rates and for longer terms than at any time in our history. The American home buyers have waded into a deep pool of mortgage debt. In the three years since V-J Day they have jumped their indebtedness (up to July 1, 1948) almost $16 billion to make a total mortgage debt of over $35 billion. And now the Federal government is aiding in giving this huge debt another boost by providing a fresh supply of easy housing credit. The rapid growth of mortgage debt has increased the volume of home building but at a tremendous cost which remains for the future to disclose.

In the opinion of many people, including myself, New York is the best spot in America to get the pulse of national business. Lately I had the opportunity to ask several New York bankers how they regarded the duration of the building boom. These men believe the amendments to the Housing Act will further inflate construction costs and force more building. They consider the new Housing Act inexpedient legislation but they are glad it is no worse. They also doubt that residential construction will carry through next year at its present high tempo as more people will find it difficult, if not impossible, to finance new home purchases. Then they also think that a curtailment of excessive housing demand is necessary to lessen the boom-and-bust bent, and that it can be accomplished by restrictions of mortgage credit. One of this group I know quite well and he bluffly told me that the present building situation is "lousy." He also made a wish --- rather like the ceremony of breaking a wish-bone --- that when the current boom breaks it will not be just a mild dip. Then he added he was not an advocate of a homeopathic dose when you have indigestion. From my various interviews I concluded these bankers are satisfied that building will continue very active this fall, will again be active in the spring of 1949 but will taper off rather rapidly in the following fall. They say the boom is bound to end but --- it takes a brave prophet to say when.

When all is said, most of us admit that we are in the toils of an inflationary boom and that the boom will eventually come to an end. It may go out explosively or it may limp out with a whimper. But when it goes the impact of a declining real estate market may be expected to bring an aftermath of defaults, liquidations and bankruptcies. The losses will fall on home owners with thin equities, on lending institutions with foreclosed and depreciated real estate, on the Federal government with its huge volume of mortgage insurance, and on the economy generally.

E. G. Johnson

E. G. JOHNSON